UNITED STATES TAX COURT
WASHINGTON, DC 20217 **PA**

SCOTT A. HOUSEHOLDER & DEBRA A. HOUSEHOLDER, ET AL.,	)	
Petitioner(s),	)	
v.	)	Docket No. 19150-10, 6541-12.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

O R D E R

These consolidated cases were tried in Phoenix, Arizona in September 2014, and one of the issues is whether accuracy-related penalties should be assessed against the Householders for their 2001, 2002, and 2003 tax years. The record's long since closed, and the Commissioner asks us to reopen it to admit evidence that he says shows he complied with I.R.C. § 6751(b)(1) for the penalties. Petitioners object.

This is, in short, another *Chai* ghoul. *See Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), *aff'g in part, rev'g in part* 109 T.C.M. 1206; *Graev v. Commissioner* (*Graev III*), 149 T.C. ___ (Dec. 20, 2017), *supplementing* 147 T.C. 460 (2016).

Background

Let's start with the sequence of events:

> May 28, 2010 -- The Commissioner determined tax deficiencies and accuracy-related penalties under I.R.C. § 6662 against the Householders for their 2001, 2002, and 2003 tax years.

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September 23, 2014 - September 25, 2014 -- Trial. At the trial the Commissioner did not introduce evidence of his compliance with § 6751(b)(1) for any of the penalties; the parties also never stipulated to his compliance.

January 24, 2015 - May 27, 2015 -- The parties filed their seriatim briefs; up to this point, neither party had said anything about the Commissioner's compliance (or lack thereof) with § 6751. The briefs didn't say anything about it either.

November 30, 2016 -- We issued *Graev v. Commissioner* (*Graev II*), 147 T.C. 460, 476-85 (2016), where we held that compliance with § 6751(b)(1) is not ripe for review in a preassessment deficiency case because the penalty has not yet been "assessed".

March 20, 2017 -- The Second Circuit held in *Chai*, 851 F.3d at 218-23, that we were wrong in *Graev II* and that the Commissioner had to show that he complied with § 6751(b)(1) as part of his burdens of production and proof on penalties under § 7491(c) in deficiency cases.

December 20, 2017 -- We adopted the Second Circuit's holding in *Chai* as our own in *Graev III*, 149 T.C. at ___ (slip op. at 13-15).

April 18, 2018 -- The Commissioner moved to reopen the record.

The Commissioner wants to add to the record a penalty-approval form for the § 6662 penalties that he determined against the Householders for their 2002 and 2003 tax years.[1] In support of his motion, he submitted a declaration from IRS revenue agent Kevin Willis to authenticate the penalty-approval form and show how his supervisor came to approve his penalty determination. Mr. Willis says in his declaration that Rosanne Perricelli was his immediate supervisor and, in that

[1] The Commissioner concedes the accuracy-related penalty for the 2001 tax year because he says he is unable to provide us with *any* evidence that he complied with § 6751(b)(1) for that penalty. The Commissioner also concedes any § 6662(d) (substantial understatement) penalties for all three tax years because the only penalty-approval form he could provide is one for the § 6662(c) (negligence or disregard) penalties.

capacity, she approved the proposed penalties by initialing the penalty-approval form. On the form itself, Mr. Willis is listed as the examiner, the negligence-penalty box is checked, assertions of the Householders' negligence for the tax years 2002 and 2003 are made, and the initials "RP" are scrawled in the "Group Manager Involvement Box" along with a check mark next to the word "Approved".

Should we reopen the record to admit this additional evidence? The Householders say we shouldn't. Their first argument is that we shouldn't reopen the record because the Commissioner's failure to introduce evidence at trial that he complied with § 6751(b)(1) shows a lack of diligence, and the Commissioner doesn't offer a good reason for failing to introduce the form even though he had it in his possession when he tried the cases. In the same vein, the Householders also argue they would be prejudiced if we reopened the record now to admit the Commissioner's proffered evidence because they say they have not had the chance to cross-examine Mr. Willis. Their second argument is that we shouldn't reopen the record because the form is unauthenticated and both the declaration and the form are inadmissible hearsay.

Analysis

The decision to reopen the record to admit additional evidence is within our discretion. *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 331 (1971). And the Ninth Circuit -- to which this case is presumably appealable -- will not review our decision "except upon a demonstration of extraordinary circumstances which reveal a clear abuse of discretion." *Nor-Cal Adjusters v. Commissioner*, 503 F.2d 359, 363 (9th Cir. 1974) (citing *Friednash v. Commissioner*, 209 F.2d 601 (9th Cir. 1954); *Chiquita Mining Co. v. Commissioner*, 148 F.2d 306 (9th Cir. 1945)), *aff'g* 30 T.C.M. 837 (1971); *see also Devore v. Commissioner*, 963 F.2d 280, 282 (9th Cir. 1992), *rev'g and remanding Estate of Cole v. Commissioner*, 58 T.C.M. 715 (1989).

But our discretion is not unbounded. We won't reopen the record unless the evidence that the Commissioner seeks to add is not merely cumulative or impeaching, is material to the issues involved, and probably would change the outcome of the case. *Butler v. Commissioner*, 114 T.C. 276, 287 (2000), *abrogated on other grounds by Porter v. Commissioner*, 132 T.C. 203 (2009); *see also SEC v. Rogers*, 790 F.2d 1450, 1460 (9th Cir. 1986) (trial court "should take into account, in considering a motion to hold open the trial record, the character of

the additional [evidence] and the effect of granting the motion"), *overruled on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988).

Even if the evidence is material and would change the outcomes of the cases, we still need to weigh the Commissioner's diligence (or lack thereof) against any possible prejudice to the Householders if we were to grant the motion to reopen the record. *See Snuggery-Elvis P'ship v. Commissioner*, 64 T.C.M. 1128, 1132 (1992) (citing *Zenith Radio Corp.*, 401 U.S. at 332-33; *Purex Corp. v. Procter & Gamble Co.*, 664 F.2d 1105, 1109 (9th Cir. 1981); *Mayer v. Higgins*, 208 F.2d 781, 783 (2d Cir. 1953); *Glagola v. Commissioner*, 59 T.C.M. 321 (1990)); *see also Cloes v. Commissioner*, 79 T.C. 933, 937 (1982) ("[p]roper judicial administration demands that there be an end to litigation and that bifurcated trials be avoided"); *Markwardt v. Commissioner*, 64 T.C. 989, 998 (1975) (it is our Court's "policy . . . to try all issues raised in a case in one proceeding and to avoid piecemeal and protracted litigation"). And "prejudice" in this context focuses on whether the submission after trial prevents the nonmoving party from examining and questioning the evidence as it would have during the proceeding. *Estate of Freedman v. Commissioner*, 93 T.C.M. 1007, 1013 (2007); *Megibow v. Commissioner*, 87 T.C.M. 987, 991 (2004).

We'll first consider whether the penalty-approval form is admissible and, if so, whether it satisfies the first test for reopening the record. Petitioners are right that this would be a difficult call if the Commissioner relied entirely on the business-records exception to the hearsay rule. *See* Fed. R. Evid. 803(6). We've found in other cases that penalty-approval forms can come in under that exception to the hearsay rule, but this form is filled with potential hearsay (e.g., "[t]axpayers should be subject to the negligence penalty due to their lack of reasonable care in preparing their return"). Records that qualify for the business-records exception also might be self-authenticating, but FRE 902(11) requires the party offering such a record and certification to notify the other party before trial that they intend to do that -- and that wasn't done at all here. So we would be inclined to deny the Commissioner's motion if he was relying entirely on the business-records exception.

But the Commissioner also argues that he's not interested in the form's admission for its language recommending the negligence penalty. He wants it in as a verbal act -- admitted to show that the supervisor approved the penalty, not that the penalty was justified or even what the supervisor was thinking when she approved it. He argues that this is all that's needed to show his compliance with § 6751: As the notes to FRE 801(c) state, "[i]f the significance of an offered statement lies solely in the fact that it was made, no issue is raised as to the truth of

anything asserted, and the statement is not hearsay." Fed. R. Evid. 801(c) advisory committee's note; *see also, e.g.*, *United States v. Pang*, 362 F.3d 1187, 1192 (9th Cir. 2004) ("out-of-court statements that are offered as evidence of legally operative verbal conduct are not hearsay").

The Householders, however, also argue that the penalty-approval form hasn't been properly authenticated under FRE 902(11) because Mr. Willis doesn't say he was its "custodian". We don't think that's quite what authentication here requires. FRE 901(b)(7)(B) says that the requirement of authentication is met by evidence that "a purported public record or statement is from the office where items of this kind are kept," and the notes to FRE 901(b)(7) clarify that "[p]ublic records are regularly authenticated by proof of custody, without more." Fed. R. Evid. 901(b)(7) advisory committee's note; *see also United States v. Blackwood*, 878 F.2d 1200, 1202 (9th Cir. 1989) (IRS agent's testimony that tax returns were in IRS custody -- and little else -- was sufficient to meet government's prima facie showing of authenticity). Mr. Willis says in his declaration that he has personal knowledge of the IRS's recordkeeping system and that the penalty-approval form was taken from the IRS's administrative file for petitioners. This is good enough to show the Commissioner had custody of the form, and petitioners do not, and reasonably cannot, argue that the proffered form isn't from the IRS administrative file for these cases.

We think this is enough to make the form itself admissible, at least for the years 2002 and 2003, and limited to the negligence penalty. We can also find that the form is not cumulative or impeaching, because it would change the outcome of the case by showing that the IRS complied with § 6751. *See Butler*, 114 T.C. at 287; *Rogers*, 790 F.2d at 1460. So the form is admissible, and it passes the first test for reopening the record.

We still need, however, to consider diligence and prejudice. The question of the Commissioner's diligence when it comes to *Chai* ghouls is always a little muddled. I.R.C. § 6751 has been in the Code for almost twenty years, and the trial and briefing in these cases concluded before *Graev II*, *Chai*, or *Graev III*. But the Commissioner argues that he "has not previously had the opportunity to supplement the record to respond to a section 6751(b) challenge," and it would therefore "be in the interests of justice to reopen the record for the submission of evidence of satisfaction of the requirements of section 6751(b)(1) in this case." We are not immediately persuaded by this argument: Our decision in *Graev III* didn't create new law; it interpreted a section of the Code that was in effect at the time of the trial in these cases, which we then applied to the parties before us in

that case. *See Harper v. Va. Dept. of Taxation*, 509 U.S. 86, 97 (1993) (when the Court applies a rule of federal law to the parties in a case, that rule "must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate . . . announcement of the rule"); *Hajro v. U.S. Citizenship & Immigration Servs.*, 811 F.3d 1086, 1099 (9th Cir. 2016) ("[s]ilence on the issue [of prospectivity] indicates that the decision is to be given retroactive effect").

But we do think the Commissioner might have had less reason to anticipate the importance of § 6751 in this case than in many other cases. Although *Graev III* didn't create new law, it is true that it and *Chai* are the first cases to *clarify* that § 6751(b) and § 7491(c) combine to place the burden of production on the Commissioner to show that he complied with § 6751(b) in cases where he wants a penalty. And unlike other cases where *Chai* ghouls have appeared, § 6751 never came up here in pretrial motions or discovery, and the Ninth Circuit has found that reopening the record may be justified in such a case. *See Romero v. City of Pomona*, 883 F.2d 1418, 1423 (9th Cir. 1989) (reopening the record may be justified by change in law that wasn't reasonably anticipated by existing law and substantially affects burden of proof, but there must be "reasonably genuine surprise") (internal quotations omitted), *abrogated in part on other grounds by Townsend v. Holman Consulting Corp.*, 929 F.2d 1358, 1363 (9th Cir. 1991) (en banc). There wasn't a change in law here -- in the strictest sense of the phrase -- but we also think it is possible that *Graev III*'s consequences might have surprised the Commissioner in this case where § 6751 had not been talked about at all. This is also the unusual case where petitioners can be charged equally with a lack of diligence -- they complain in their motion papers that they should have the opportunity to cross-examine Mr. Willis, but he was a witness at trial *and petitioners did in fact cross-examine him*. It's just that they, like the Commissioner, weren't thinking about § 6751 at the time.

The Commissioner therefore doesn't completely fall down on the diligence part of the test, so let's see how he fares with prejudice. The Householders argue that admitting the form now would prejudice them because they wouldn't get to ask any witnesses about it. They list several questions they'd want answers to: Was Rosanne Perricelli Kevin Willis' *immediate* supervisor? Does the form represent the *initial* determination that a penalty was appropriate? How does Willis know *Perricelli* was the one who wrote "RP" on the form? Why isn't *she* the one making the declaration? And why isn't the form clearer about *which* years the approved penalties are for?

These are good questions, but we doubt that getting to ask them would've benefitted the Householders. Willis testified at trial that Perricelli -- whose initials are of course "RP" -- was his "boss" in May 2007, which was only two months after the date on the form and is three years before the Commissioner issued the notice of deficiency. And although it's odd that the form doesn't say at the top what tax years it's for, it specifically mentions 2002 and 2003 in the box for "Reason(s) for Assertions/Non-Assertions of Penalty(s)." It's therefore unlikely that cross examining Willis about the form would've helped the Householders, which means we can't conclude that reopening the record to admit it now would prejudice them.

The Commissioner could've been more diligent. But the Householders could have been as well -- in those days before *Chai* and *Graev III* it was not at all clear that the burden of production in raising the Commissioner's noncompliance with § 6751 would fall on the Commissioner rather than being an affirmative defense for taxpayers. Neither party raised it, though, and it appears to us that any lack of diligence on the Commissioner's part is counterbalanced here by the probative value of the evidence and the lack of prejudice to the Householders if we reopen the record to admit it.

It is therefore

ORDERED that respondent's April 18, 2018 motion to reopen the record is granted to the extent it seeks the admission of the penalty-approval form that is attached to his motion. It is also

ORDERED that the Clerk of the Court is directed to detach the Civil Penalty Form and file it as a separate document.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
July 12, 2018